No. [illegible]

In the Supreme Court of the United States

October Term, 19[illegible]

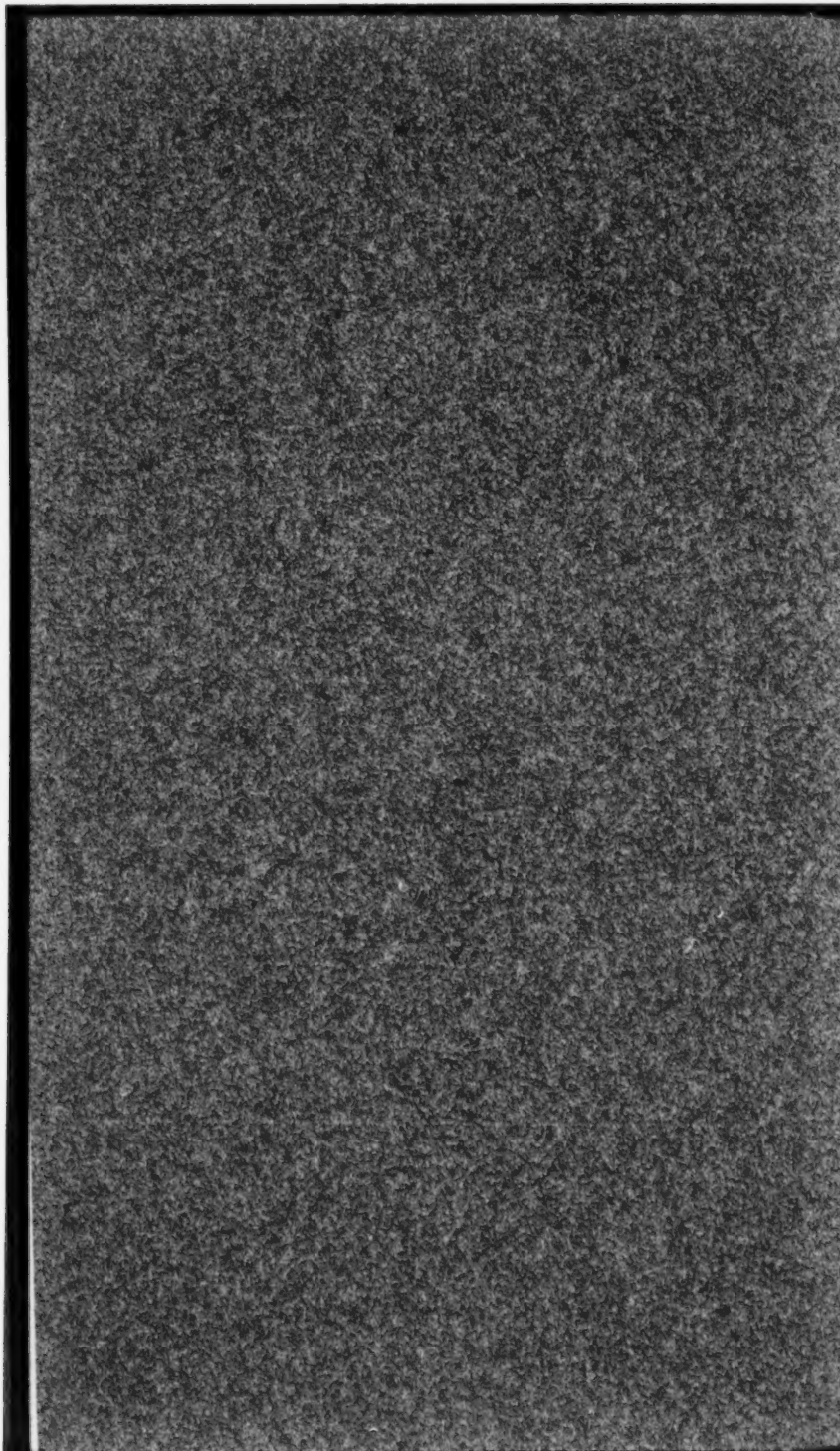
C. O. W[illegible]

v.

The United States of America

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR THE UNITED STATES



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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1926

No. 766

C. O. WESTFALL

v.

THE UNITED STATES OF AMERICA

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINION BELOW

As the case comes here on certificate from the Circuit Court of Appeals, no opinion was rendered below.

JURISDICTION

The jurisdiction of the Court to answer the question certified by the Circuit Court of Appeals is conferred by Section 239 of the Judicial Code, as amended by the Act of February 13, 1925.

THE QUESTION

The question certified is:

> Is the provision of Section 9, Chapter 6, of the Federal Reserve Act of December 23, 1913, as amended June 21, 1917, and July 1,

> 1922, constitutional in so far as it provides that "such banks and the officers, agents and employes thereof shall also be subject to the provisions of and to the penalties prescribed by Section 5209 of the Revised Statutes"?

The section of the Revised Statutes referred to makes it an offense for an officer or an employee of a Federal Reserve or member bank to embezzle or misapply its funds. The ultimate question in this case is whether State banks, members of the Federal Reserve system, are agencies of the United States, so that the United States has power to protect them by penal legislation from embezzlement of their funds.

THE STATUTES

That portion of the Federal Reserve Act of December 23, 1913 (c. 6, 38 Stat. 251, 260), set forth in Section 9 thereof, which makes the provisions of Section 5209, R. S., applicable to misconduct of officers, agents, and employees of member banks, reads as follows:

> Such banks, and the officers, agents, and employees thereof, shall also be subject to the provisions of and to the penalties prescribed by sections fifty-one hundred and ninety-eight, fifty-two hundred, fifty-two hundred and one, and fifty-two hundred and eight, and fifty-two hundred and nine of the Revised Statutes. * * *

Section 5209 of the Revised Statutes of the United States as amended by the Act of September 26, 1918

(c. 177, 40 Stat. 967, 972), so far as pertinent, reads as follows:

> Any officer, director, agent, or employee of any Federal reserve bank, or of any member bank as defined in the Act of December twenty-third, nineteen hundred and thirteen, known as the Federal reserve Act, who embezzles, abstracts, or willfully misapplies any of the moneys, funds, or credits of such Federal reserve bank or member bank, or who, without authority from the directors of such Federal reserve bank or member bank, issues or puts in circulation any of the notes of such Federal reserve bank, or member bank, or who, without such authority, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, draft, bill of exchange, mortgage, judgment, or decree, or who makes any false entry in any book, report, or statement of such Federal reserve bank or member bank, with intent in any case to injure or defraud such Federal reserve bank or member bank, or any other company, body politic or corporate, or any individual person, or to deceive any officer of such Federal reserve bank or member bank, or the Comptroller of the Currency, or any agent or examiner appointed to examine the affairs of such Federal reserve bank or member bank, or the Federal Reserve Board; and every receiver of a national banking association who, with like intent to defraud or injure, embezzles, abstracts, purloins, or willfully misapplies any of the moneys,

Section 4 of the same Act reads in part as follows:

> Every Federal reserve bank shall be conducted under the supervision and control of a board of directors.
>
> The board of directors shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law.
>
> Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks.

Section 9 of the same Act as amended by the Act of June 21, 1917 (c. 32, 40 Stat. 232), and by the Act of March 4, 1923 (c. 252, 42 Stat. 1454, 1478), reads in part as follows:

> Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, desiring to become a member of the Federal Reserve System, may make application to the Federal Reserve Board, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe

to as a national bank. The Federal Reserve Board, subject to such conditions as it may prescribe, may permit the applying bank to become a stockholder of such Federal reserve bank.

In acting upon such applications the Federal Reserve Board shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this Act.

Whenever the Federal Reserve Board shall permit the applying bank to become a stockholder in the Federal reserve bank of the district its stock subscription shall be payable on call of the Federal Reserve Board, and stock issued to it shall be held subject to the provisions of this Act.

All banks admitted to membership under authority of this section shall be required to comply with the reserve and capital requirements of this Act and to conform to those provisions of law imposed on national banks which prohibit such banks from lending on or purchasing their own stock, which relate to the withdrawal or impairment of their capital stock, and which relate to the payment of unearned dividends. * * *

As a condition of membership such banks shall likewise be subject to examinations made by direction of the Federal Reserve Board or of the Federal reserve bank by examiners selected or approved by the Federal Reserve Board.

* * * * *

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held for its account by the Federal reserve bank * * *.

Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount, and the notes, drafts, and bills of exchange of factors issued as such making advances exclusively to producers of staple agricultural products in their raw state shall be eligible for such discount * * *.

Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, and subject to regulations and limitations to be prescribed by the Federal Reserve Board, any Federal reserve bank may discount or purchase bills of exchange payable at sight or on demand

which are drawn to finance the domestic shipment of nonperishable, readily marketable staple agricultural products and are secured by bills of lading or other shipping documents conveying or securing title to such staples * * *.

* * * * *

Any member bank may accept drafts or bills of exchange drawn upon it having not more than six months sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods; or which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per centum of its paid-up and unimpaired capital stock and surplus, unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance; and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half of its paid-up and unimpaired capital stock and surplus: *Provided, however*, That the Federal Reserve Board, under such general regulations as it may prescribe, which shall apply to all banks

alike regardless of the amount of capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus * * *.

Any Federal reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days at rates to be established by such Federal reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act, or by the deposit or pledge of bonds or notes of the United States.

* * * * *

Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board, by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions. * * *

Section 13 (a) of the same Act, added by the Act of March 4, 1923 (c. 252, 42 Stat. 1454, 1479), provides in part as follows:

Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Federal Reserve Board, discount notes, drafts, and bills of exchange issued or drawn for an agricultural purpose, or based upon live stock, and having a maturity, at the time of discount, exclusive of days of grace, not exceeding nine months, and such notes, drafts, and bills of exchange may be offered as collateral security for the issuance of Federal reserve notes under the provisions of section 16 of this Act * * *.

Section 15 of the same Act reads as follows:

The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes and the funds provided in this Act for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.

No public funds of the Philippine Islands, or of the postal savings, or any Government

> funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act: *Provided, however,* That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories. * * *

Section 16 of the same Act as amended by the Act of September 7, 1916 (c. 461, 39 Stat. 752, 754), and by the Act of June 21, 1917 (c. 32, 40 Stat. 232, 236, 238), provides in part as follows:

> Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in gold on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank.
>
> Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes,

drafts, bills of exchange, or acceptances acquired under the provisions of section thirteen of this Act, or bills of exchange indorsed by a member bank of any Federal reserve district and purchased under the provisions of section fourteen of this Act, or bankers' acceptances purchased under the provisions of said section fourteen, or gold or gold certificates; but in no event shall such collateral security, whether gold, gold certificates, or eligible paper, be less than the amount of Federal reserve notes applied for. * * *

* * * * *

Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank. * * *

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks. * * *

Section 19 of the same Act as amended by the Act of August 15, 1914 (c. 252, 38 Stat. 691), and by the

Act of June 21, 1917 (c. 32, 40 Stat. 232, 239), reads in part as follows:

> The required balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: *Provided, however*, That no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored.

Section 5 of the Federal Farm Loan Act of July 17, 1916 (c. 245, 39 Stat. 360, 365), provides in part as follows:

> At least twenty-five per centum of that part of the capital of any Federal land bank for which stock is outstanding in the name of national farm loan associations shall be held in quick assets, and may consist of cash in the vaults of said land bank, or in deposits in member banks of the Federal reserve system, or in readily marketable securities which are approved under rules and regulations of the Federal Farm Loan Board: *Provided*, That not less than five per centum of such capital shall be invested in United States Government bonds.

Section 13 of the same Act reads in part as follows:

> That every Federal land bank shall have power, subject to the limitations and requirements of this Act—
>
> * * * * *

> Fifth. To deposit its securities, and its current funds subject to check, with any member bank of the Federal Reserve System, and to receive interest on the same as may be agreed.

Section 27 of the same Act reads in part as follows:

> Any member bank of the Federal Reserve System may buy and sell farm loan bonds issued under the authority of this Act.

By Section 15 of the War Finance Corporation Act of April 5, 1918 (c. 45, 40 Stat. 506, 510), and Section 212 of the Agricultural Credits Act of March 4, 1923 (c. 252, 42 Stat. 1454, 1469), member banks of the Federal Reserve System, were made authorized depositories for funds of the War Finance Corporation and the National Agricultural Credit Corporations.

SUMMARY OF ARGUMENT

The member banks of the Federal reserve system, whether corporations organized under State law or Act of Congress, are essential parts of that system. By reason of their relation to the system, they are instrumentalities of the Federal Government, and because of that the United States has a direct interest in protecting them in their capacity to function as a part of the Federal reserve system.

Congress has power to use State corporations as instrumentalities of the Federal Government.

ARGUMENT

THE MEMBER BANKS OF THE FEDERAL RESERVE SYSTEM, WHETHER CORPORATIONS ORGANIZED UNDER STATE LAW OR ACT OF CONGRESS, ARE INSTRUMENTALITIES OF THE FEDERAL GOVERNMENT, WHICH IT HAS THE POWER TO PROTECT

The provisions of the Federal Reserve Act disclose that the member banks of the Federal reserve system, national banks and State banks alike, play an important and essential part in carrying out the purposes of the statute. The member banks are the stockholders in and furnish the capital of the Federal reserve banks. It is through their membership in the Federal reserve system and through deposits in Federal reserve banks that the member banks maintain their reserves, and it is through the maintenance of such reserves by the member banks that the Federal reserve banks are enabled to control and use the banking reserves of the country to the best advantage.

It is upon the volume of commercial paper coming into the hands of member banks and endorsed by them and rediscounted by the Federal reserve banks that the volume of elastic currency very largely depends. The Federal reserve notes supplied by this system to expand and contract the currency of the country as conditions require are issued to the Federal reserve banks by the United States upon a pledging by the banks of collateral security, an important part of which is commercial paper acquired by the Federal reserve banks from the member banks and which

bears the endorsement of member banks. The provisions for a safe and elastic currency and the creation of a real and available reserve depend upon the member banks. Without them the Federal reserve system would not function. The financial stability of the member banks is of prime importance to the system. They are as much agencies or instrumentalities of the United States as are the Federal reserve banks. It is of no consequence that some of the member banks are corporations organized under State law and some of them are national banks organized under Acts of Congress. As member banks their relations to the Federal reserve system are substantially the same. In the execution of any power resting in the United States under the Constitution, Congress may employ as instrumentalities corporations organized under State law.

Cherokee Nation v. *Southern Kansas Ry. Co.*, 135 U. S. 641.

California v. *Pacific R. R. Co.*, 127 U. S. 1.

> Nothing in the Constitution forbids the selection of a state corporation as a national agent. In reason the material thing is the principal's authority, not the parentage or birthplace of the agent. (*Latinette* v. *City of St. Louis*, 201 Fed. 676, 679.)

It has long been established that Congress has power, by appropriate legislation, to protect agencies or instrumentalities of the United States against attack or injury which would interfere with the performance of their functions or impair their efficiency

as such. *United States* v. *Walter*, 263 U. S. 15. There, construing a statute which made the criminal laws respecting the defrauding of the United States apply to "any corporation in which the United States of America is a stockholder," the Court held it referred only to corporations, like the Fleet Corporation, which are instrumentalities of the Government and in which, for that reason, the United States owns stock. It said the fraud, if successful, "even more immediately would have impaired the efficiency of its very important instrument."

> See *In re Neagle*, 135 U. S. 1; *Thornton* v. *United States*, 271 U. S. 414; *In re Quarles and Butler*, 158 U. S. 532, 535; *McCulloch* v. *Maryland*, 4 Wheat. 316; *Osborn* v. *United States Bank*, 9 Wheat. 738; *Van Allen* v. *The Assessors*, 3 Wall. 573; *Logan* v. *United States*, 144 U. S. 263, 293.

An Act of Congress which makes it a penal offense to embezzle funds of a State bank, a member of the Federal Reserve system, does not infringe on any State power or prevent the State from punishing the offense. The same Act may constitute an offense against each of the two sovereignties. *United States* v. *Lanza*, 260 U. S. 377.

On the theory that member banks, whether State or Federal corporations, are agencies and instrumentalities of the United States, Congress has not only provided for punishment of those who misappropriate their funds, but has regulated State member banks by requiring them to comply with the reserve

and capital requirements of the Act, and to conform to those provisions of law imposed upon national banks, which prohibit such banks from lending on or purchasing their own stock, which relate to withdrawal or impairment of their capital stock, and which relate to the payment of unearned dividends.

All of these provisions must stand or fall together with the one here under consideration. It is evident that the discharge of their functions by the Federal reserve banks can be assured only as the activities and the continuance as going concerns of member banks are maintained. Member banks are by statute made essential factors in carrying out the purposes of the Act and have been selected as Federal instrumentalities under the wide latitude and discretion which is always accorded the Congress in determining whether any agency it selects is appropriate or necessary. If instead of utilizing State corporations as member banks Congress had itself created the member banks as it did the Federal reserve banks, doubtless it would be conceded that such banks would be Federal agencies. The mere fact that some of the agencies selected were corporations organized under State statutes does not make them any less agencies of the United States. They are as much agencies of the United States as are the Federal land banks. *Smith* v. *Kansas City Title Co.*, 255 U. S. 180. Anything that impairs or destroys the integrity of the member banks to that extent interferes with and hampers the operation of the Federal reserve system.

Westfall's contentions are plainly contrary to established principles.

In *Hiatt* v. *United States*, 4 F. (2d) 374, the Circuit Court of Appeals for the Seventh Circuit considered the question here presented and said (p. 377):

> When the Federal Reserve System was created, the banking business of the states and of the nation was done by national banks incorporated under federal law, state banks incorprated under state laws, and unincorporated private banks. While there had necessarily grown up business relations between the various banks, regardless of their origin, they were largely voluntary. Without going fully into the causes which produced the Federal Reserve System or the purposes of its creation, further than those expressed in the title, viz. "To provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes," it is sufficient to say that it had long been recognized that for the purpose of carrying on undisturbed the necessary business and financial operations of the government some system should be devised whereby the banking operations of the country could be controlled and sudden and violent crises in financial affairs prevented. If, in the wisdom of Congress, it seemed that the inclusion of state banks and trust companies would contribute to such and other legitimate purposes of the Federal Reserve System, the

> right to so include them would seem not now open to question. The government may make use of concerns incorporated under state charters. *Latinette* v. *City of St. Louis*, 201 F. 676, 120 C. C. A. 638, decided by this court; *Cherokee Nation* v. *Kansas Ry. Co.*, 135 U. S. 641, 10 S. Ct. 965, 34 L. Ed. 295; *California* v. *Pacific R. R. Co.*, 127 U. S. 1, 8 S. Ct. 1073, 32 L. Ed. 150. The provision for membership of state banks in the Federal Reserve System is in no sense compulsory. We are of opinion that Congress was clearly within its constitutional rights in authorizing the admission of state banks and trust companies to the privileges and benefits of member banks in the Federal Reserve System.

In disposing of the immediate question, the court said (p. 377):

> It is urged that the provisions of section 5209 (Comp. St. § 9772), supra, as thus applied are repugnant to the federal Constitution and beyond the power of Congress, the theory being that they necessarily withdraw from the state the power to enact criminal laws with respect to the same offenses and suspend the operation of such criminal statutes touching the offenses enumerated in the section. The main reliance, in support of this contention, is upon *Easton* v. *Iowa*, 188 U. S. 221, 23 S. Ct. 288, 47 L. Ed. 452. That case and others cited are examples of attempts on the part of the state to punish, as criminal, certain acts done, not only by officers of state banks, but also by officers of national banks,

> and the Supreme Court held that such statutes, as applied to national banks are void, but the reasons there urged have nothing to do with the question here involved. It is to be noted that the acts which were made offenses under section 5209 are those committed by officers of a state bank pertaining to matters affecting the relations between the member bank and the Federal Reserve Bank. It must be apparent that the commission of acts made punishable by that section would necessarily affect the relations between the member bank and the Federal Reserve Bank, and also would affect injuriously the Federal Reserve Bank System. * * *

In that case a petition for certiorari was filed in this Court May 8, 1925, and denied June 1, 1925. *Hiatt, Petitioner*, v. *United States*, 268 U. S. 704.

One of the questions raised by the petition for certiorari in that case (page 5) was:

> Are the provisions of the Federal Reserve Act constitutional in so far as they purport to incorporate State loan, trust and safe deposit companies into the Federal Reserve System as member banks, and are the Federal penal acts constitutional in so far as applicable to such state corporation.

The Circuit Court of Appeals for the Sixth Circuit, which certified this case here, does not appear to have had the *Hiatt* case called to its attention, as it is not mentioned in either brief in the Circuit Court of Appeals, nor in the brief filed in this Court on

behalf of Westfall. This may explain the action of the court below in certifying the case.

That Westfall, although not himself an officer or employee of the member bank, may be punished under Section 5209 of the Revised Statutes for aiding or abetting or conspiring with an officer of the bank is shown in *Coffin* v. *United States*, 156 U. S. 432, 447.

CONCLUSION

The question certified should be answered in the affirmative.

Respectfully submitted.

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MARCH, 1927.

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